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SUBJECT: NZ EMISSIONS TRADING SCHEME UNDER REVIEW

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¶1. (SBU) Summary. On December 9, 2008, the newly elected National-led Government announced its review of the country's Emissions Trading Scheme (ETS). Established by the previous Labour government, the ETS attracted criticism from many quarters, including the National Party, for its lack of political consensus and its potentially adverse impact on economic growth. Insiders predict that any new legislation will not repeal the existing ETS but rather amend it to give greater weight to its economic impact. A harmonized approach to emissions trading with Australia is seen as desirable by National and both governments have begun to jointly study this option. End Summary.

PM Key Favors Fiscally Prudent ETS

¶2. (SBU) Prime Minister John Key believes that humans have contributed to global warming and that New Zealand should have an effective system to reduce the country's greenhouse gas emissions and enable the trading of emission reduction credits. However, PM Key has stated that he will only support such a system if it does not punitively impact the New Zealand economy. Before the 2008 election, Key's opposition National Party was critical of the previous Labour Government's Climate Change Response Amendment Act 2008, which established New Zealand's Emissions Trading Scheme (ETS) (reftel). Key argued that Labour's ETS was established without the due diligence and political debate required to form the political consensus essential to address a significantly long-term issue, such as climate change. Additionally, Key asserted that any ETS should have as a fundamental consideration its impact on domestic economic growth.

ETS Still in Place, but Under Comprehensive Review

¶3. (SBU) Following the November 2008 election, the newly formed National-led government chose not to repeal ETS, but rather to initiate a parliamentary study of the program. On December 9, 2008, Key announced the creation of a Select Committee of Inquiry (Review Committee) to review the ETS and consider alternative mechanisms for addressing climate change. This announcement honored a commitment made to the hard-right ACT Party to secure its support in forming a government after the election. While the Review Committee conducts its examination, the ETS program will remain in force despite pressure from ACT to suspend its operation. However, the first stage of the ETS emissions reduction timetable does not commence until 2010, which leaves some time to review and amend the program.

Scope of ETS Review Committee Inquiry

14. (U) The Review Committee has announced that, during the course of its inquiry, it will:

- Hear views from trade and diplomatic experts on the international relations aspects of this issue;
- Consider the prospects for an international agreement on climate change post-Kyoto 1, and the form such an agreement might take;
- Require a high-quality, quantified regulatory impact analysis to identify the net benefits or costs to New Zealand of any policy action, including international relations and commercial benefits and costs;
- To identify the central/benchmark projections which are being used as the motivation for international agreements to combat climate change; and consider the uncertainties and risks surrounding these projections;
- Consider the impact on the New Zealand economy and New Zealand households of any climate change policies, having regard to the weak state of the economy, the need to safeguard New Zealand's international competitiveness, the position of trade-exposed industries, and the actions of competing countries;
- Examine the relative merits of a mitigation or adaptation approach to climate change for New Zealand;
- Consider the case for increasing resources devoted to New Zealand-specific climate change research;

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- Examine the relative merits of an emissions trading scheme versus a tax on carbon or energy as a New Zealand response to climate change;
- Consider the need for any additional regulatory interventions to combat climate change, whether through an ETS or a new form of taxation, such as a carbon tax; and
- Consider the timing of the introduction of any New Zealand measures, with particular reference to the outcome of the December 2009 Copenhagen meeting, the position of the United States, and actions by the Australian government.

Committee Composition and Timeline

15. (SBU) The Review Committee is comprised of members from many of the political parties sitting in Parliament with a view to obtaining a balanced consideration of and consensus on other alternatives. National, as Parliament's biggest party, has four seats; Labour three seats; the Green Party, Maori Party, ACT and United Future all have one seat.

16. (SBU) In an unusual move, Key appointed a minister outside of Cabinet, United Future leader Peter Dunne, to chair Review Committee. Dunne is Revenue Minister and Associate Health Minister. It is an unusual appointment because ministers do not usually sit on committees involving legislation. Key justified the appointment on the grounds that Dunne is an experienced member of Parliament and generally considered neutral on this issue. Although the Green Party questioned how neutral a government minister could be in the position of chair, Dunne's appointment was generally well-received inside and outside of parliament. Dunne is pro-ETS and soon after his appointment stated that "New Zealand needs a robust emissions trading scheme in place as quickly as possible to reassure businesses and shore-up our international credibility".

17. (U) The Committee held its first meeting on December 18, 2008 and has met several times since. It plans to report back to

Parliament in April/May 2009. The Government intends to pass any proposed legislation by September 30, 2009, before the scheduled implementation of the existing ETS program that begins in 2010.

Three Possible Outcomes of the ETS Review

¶8. (SBU) Rob Eaddy, Chief of Staff to Committee Chair Dunne, offered post three possible scenarios at the conclusion of the Review Committee process. The most likely outcome, according to Eaddy, is a proposal to revise the existing ETS in a manner that earns broad political support and which gives more consideration to the impact on the domestic economy. Another scenario posited by Eaddy involves the Committee recommending the imposition of a carbon tax in lieu of the carbon market feature within an ETS. However, Eaddy believed this to be the least likely scenario.

¶9. (SBU) Eaddy's third scenario is one in which Australia and New Zealand create a tandem scheme that recognizes the strengths and weaknesses of their respective economies. Eaddy added that this outcome has long been Key's most favored solution and revealed that Key canvassed this concept with Australian PM Kevin Rudd when they met on March 2 in Sydney.

GNZ and GOA Announce Talks to Harmonize Plans

¶10. (SBU) Meanwhile, as the Review Committee works toward a proposed solution, the GNZ and GOA are looking seriously at the harmonization option. On March 20, NZ Climate Change Minister Nick Smith and Australia Minister for Climate Change and Water Penny Wong announced the establishment of a trans-Tasman working group to explore harmonization of their countries' respective emissions reduction and carbon trading regimes. According to Smith and Wong, options include everything from common adoption of key design elements to a full harmonization. No timelines were set by Smith and Wong.

¶11. (SBU) Leading NZ business journalist Brian Fallow has, however, expressed doubt that NZ and Australia can easily reconcile differences in their respective approaches towards emissions trading. Fallow asserted that beyond the political rhetoric lays the reality of various stumbling blocks that may make harmonization

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very difficult or perhaps unfeasible under policies. Fallow cited differences between the two countries in how they each plan to meet Kyoto targets and how emission units would be traded.

Political Parties on ETS Review

¶12. (SBU) National's support partner, the ACT Party, opposes any form of an ETS. ACT believes carbon trading is prone to fraud and that no case has yet been made to prove that the benefits of an ETS would exceed the costs. The Labour Party and the Green Party have both offered to work with the Government on an amended ETS. Labour's Climate Change spokesman Charles Chauvel acknowledges that the governing National Party is firmly in the driver's seat on the ETS review. [Note. Even Labour and the Greens, who have historically advanced strong pro-environment policies, now realize that their positions must take into account the realities of the present global economic situation and its impact on achievable environmental goals. End Note]. Minister Smith welcomed the Labour and the Greens respective offers and reaffirmed the Government's desire to build political consensus on how best to tackle climate change. Jim Anderton, the solitary Progressive Party MP, supports an ETS, as does the Review Committee Chair Peter Dunne, United Future's only MP. The Maori Party has yet to articulate a position on the ETS.

Insights on NZ's Post-Kyoto Negotiations

¶13. (SBU) Tim Groser, New Zealand's Minister for International Climate Change Negotiations, expressed his disappointment in a March

23 media interview that the December 2008 Posnan talks yielded little progress toward negotiation of a post-Kyoto agreement. According to Groser, the best that can be achieved in the Copenhagen talks planned for December 2009 will be some kind of framework agreement.

¶14. (SBU) Groser also discussed New Zealand's perspective as it enters into post-Kyoto negotiations. NZ's greenhouse gas emissions are "massively in excess of our Kyoto obligations", according to Groser, "and taking on even more ambitious targets is a tough ask." In addition, he commented that NZ is uniquely and badly placed among Kyoto signatories because "there is no technical fix for methane emitted from livestock." NZ must, stated Groser, take into account the large percentage of NZ greenhouse gas emissions that are generated by agriculture (49 percent), and the unavailability of technology that would allow NZ to reduce those emissions.

¶15. (SBU) Another issue for New Zealand in future negotiations is forestry, said Groser. He explained that the Kyoto rules assume that all carbon from trees is released as soon as the trees are cut down, but that is not true. Consequently, Kyoto imposes a penalty when trees are cut down, even though they are replanted in another place. That result penalizes New Zealand, which wants to transfer more of its forests to marginal hill country.

Comment

¶16. (SBU) Given the current economic situation and the GNZ's desire to avoid any measures that could negatively affect NZ's export earnings (which are predominately agriculturally based), we anticipate the GNZ will study this issue carefully and delay as long as politically possible the implementation of ETS measures for the ag sector. The public and much of the political clamor for New Zealand to meet its Kyoto obligations have quieted since the global financial crisis. New Zealand environmentalists and the small band of dogmatic pro-environment politicians are likely to press the Government towards committing to firm targets in the lead up to Copenhagen, while NZ and Australia officials examine what is realistic for both their economies. End Comment.

Keegan